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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)	
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	

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OFFICE OF THE SECRETARY

WORLDCOM COMMENTS

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WORLDCOM COMMENTS

WorldCom, Inc. (WorldCom) submits these comments in response to the Notice of Proposed Rulemaking (Notice) released by the Commission in the above-captioned proceeding on April 27,2001. WorldCom supports the Commission's effort to establish a uniform system for intercarrier compensation arrangements that will eliminate existing opportunities for uneconomic arbitrage caused by the patchwork of rules governing the treatment of traffic subject to regulatory classifications. The adoption and implementation of such reforms, however, must be carried out in a manner that does not seriously undermine the achievement of fundamental public interest goals, such as the promotion of efficient competition in local telecommunications markets.

I. Introduction and Summary

The Commission's initial objective in this proceeding should be the adoption of clear criteria for evaluating alternative approaches to a uniform system of intercarrier compensation. The Notice proposes a few criteria, but additional standards are needed for a comprehensive framework.

The Notice, for example, stresses the importance of fostering economically efficient compensation arrangements. In WorldCom's view, such arrangements also should promote the development of competition in local telecommunications markets, which remain dominated today by incumbent local exchange carriers (LECs). In particular, rules governing intercarrier compensation should be designed to curb the exercise of market power by incumbent LECs. In addition, the Commission's assessment of different approaches to intercarrier compensation should examine whether they are technologically and competitively neutral and whether they minimize transaction costs. Further, the evaluation of alternative proposals should ensure that the anticipated benefits of implementing a particular proposal clearly outweigh the costs, including the disruption to existing arrangements, that carriers will be forced to incur. For example, the Commission should reject reform proposals that would require carriers to undertake significant changes to the design of their existing networks. This consideration is particularly important because of the ongoing transformation of carriers' networks from circuit-switched to packet-switched technology.

Finally, the Commission should avoid a piece-meal approach to reforming intercarrier compensation arrangements. For example, implementing a bill and keep scheme for local traffic while delaying reform of interstate and intrastate access may confer substantial, unjustified benefits on incumbent LECs while disadvantaging interexchange carriers (IXCs).

As an initial matter, the FCC should make clear that rules that it may adopt to govern intercarrier compensation arrangements will apply only as a default in the event that carriers are unable to reach agreement through negotiation. Government intervention in interconnection arrangements is generally needed only where one of the parties to the agreement exercises market power. The FCC has recognized this fact in various decisions stretching over more than 20 years in which it has declined to regulate the prices and practices of carriers that lacked market power. In addition, the Commission has gradually relaxed and eliminated pricing controls in markets that evolved from monopolies to competitive markets.

A fundamental obstacle to the Commission's ability to achieve its goal of a unified, integrated regime for intercarrier compensation is that it lacks authority over key components of the existing set of rules. Specifically, although the Notice suggests that the adoption of some form of a bill and keep mechanism for all such arrangements, the Commission currently lacks authority to impose such a requirement for intrastate access charges. Further, the Communications Act of 1934, as amended (Act) bars the FCC from imposing a bill and keep regime for the exchange of local traffic in circumstances where the traffic exchanged is not relatively balanced in each direction, unless the Commission determines that a carrier does not incur any additional costs to terminate traffic delivered by another carrier. That finding would require the FCC, in turn, to require that the charges for unbundled switching be flat-rated.

The Notice seeks comment on two different approaches to a bill and keep regime: Central Office Bill and Keep (COBAK) and Bill Access to Subscribers Interconnection Costs Split (BASICS). As a practical matter, COBAK at this time appears to be a more fully developed, more easily implemented proposal. **As** the attached Declaration of Dr. Patrick DeGraba (DeGraba Declaration) explains, the paper describing COBAK released by the FCC's Office of Plans and Policy (OPP) does not address many of the critical issues surrounding implementation of a COBAK system. In particular, assuming a COBAK regime could be implemented for all intercarrier interconnection arrangements, the Commission would need to ensure that its plan contained adequate protections against the ability of incumbent LECs to exercise their market power to disadvantage their rivals in local and long distance markets. For example, adoption of a COBAK system for interstate access service could deprive IXCs of scale efficiencies they currently enjoy in local transport arrangements and also enable incumbent LECs to degrade the quality of interconnection provided to IXCs.

Because of the statutory limits on the Commission's authority to establish intercarrier compensation rules applicable to all interconnection arrangements between incumbent LECs and other carriers, WorldCom recommends the adoption of a uniform rate for call termination based on the pricing principles set forth in section 251 of the Act and the FCC's implementing rules. To implement such a rate based on forward-looking costs would require the Commission to work cooperatively with state commissions toward the adoption of that rate for intrastate access termination. In the meantime, the Commission can make significant progress toward a more rational and efficient intercarrier pricing regime by affirming its existing local interconnection rules, eliminating originating traffic sensitive interstate access charges, and permitting IXCs to continue to control the routing of originating and terminating interstate access traffic.

II. The Commission Must Include the Promotion of Competition in its Goals for Intercarrier Compensation Reform

The Commission begins its discussion by seeking comment on the appropriate goals for intercarrier compensation regulations. The Commission's initial objective in this proceeding should be to establish clear criteria for evaluating alternative approaches to a uniform system of intercarrier Compensation. The Notice suggests a few such criteria, but falls short of outlining a comprehensive set of goals that reform of existing intercarrier compensation arrangements should advance. In addition to the goals identified by the Commission of promoting efficiency, technological and competitive neutrality, and ease of administration, intercarrier compensation reform must be accomplished in a manner that promotes competition, particularly in local markets that are still dominated by the incumbent LECs.

Although reform of existing intercarrier compensation mechanisms should promote economically efficient arrangements for exchanging traffic among carriers, a new regime should also advance other public interest objectives, such as competition, particularly in local markets that today remain dominated by incumbent LECs.[1] Government oversight of interconnection arrangements generally is only necessary in circumstances where one of the carriers involved has market power. Where neither party to an interconnection arrangement can exercise market power, such as agreements between competitive LECs or agreements between Internet Service Providers (ISPs), marketplace forces will drive the parties to agree on economically efficient arrangements. Hence, where possible, the Commission should adopt a uniform system for intercarrier compensation that fosters competition and, consequently, over time, will reduce the need for regulatory intervention.

[1] There can be no question that the incumbent LECs continue to dominate local exchange markets throughout the country. According to the Commission's own data, competitive LECs provide service to only 8.5% of the total local telephone lines in service, and serve only 35% of those lines over their own loop facilities. *Local Telephone Competition: Status us of December **31,** 2000,* Industry Analysis Division, Federal Communications Commission, May 2001 at 1.

Indeed, the Commission can best promote efficiency by promoting competition.[2] No goal should be more important in assessing different intercarrier compensation proposals than the promotion of efficient competition, especially in local markets. Moreover, as the Commission has observed, promoting competition was a primary goal of Congress in passing the Telecommunications Act of 1996 and therein requiring incumbent LECs to interconnect with any telecommunications carrier that requests interconnection.[3] The Commission must make the efficient development of competition, in markets where some carriers continue to possess market power, the foremost goal of intercarrier compensation reform.

A corollary of promoting competition is controlling the exercise of market power as long as it exists. Reform of intercarrier compensation should be undertaken in a manner that curbs the ability of incumbent LECs to exercise their market power.

The Commission should also consider whether a particular intercarrier compensation regime is technologically and competitively neutral. The Commission has applied this criterion in other contexts, such as number portability cost recovery. Technological and competitive neutrality help to ensure that the marketplace, not advantages of incumbency achieved during a time of legal monopoly, determines which technologies and which competitors succeed.

Other things equal, the Commission should adopt intercarrier Compensation rules that minimize the need for regulatory intervention. However, it is important to keep in

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[2] The Commission has consistently recognized that competition, where it develops, is the best driver of efficiency. *See, e.g., In the Matter of Access Charge Reform, CC* Docket No. 96-262, First Report and Order (rel. May 16, 1997), ¶ 263.

[3] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* CC Docket No. 96-98, First Report and Order (rel. August 8, 1996), ¶ 3.

mind that, ultimately, the reason the Commission has commenced this proceeding is because the incumbents continue to exercise market power. Reforming intercarrier compensation arrangements in a manner that promotes competition will also, in the long run, advance the goal of minimizing the need for regulatory intervention.

The Commission must be aware that interLATA entry may create new incentives and opportunities for the BOCs to exercise their control over local networks to disadvantage rivals in both local and interexchange markets. As interLATA service providers, the BOCs will have new opportunities to exploit their control of ubiquitous local access facilities. For example, they may attempt to degrade the quality of interconnection that they provide to their interLATA competitors in order to gain a competitive advantage. As the DeGraba Declaration demonstrates, simply introducing some type of bill-and-keep arrangement for intercarrier compensation will not eliminate incumbent LEC market power. According to Dr. DeGraba, "a [bill-and-keep] regime in most instances would neither create nor eliminate the ability and incentive of incumbent LECs to disadvantage rivals."[4] Given the incumbent LECs' continued market power, the Commission cannot, at this time, shirk its responsibility to continue to regulate interconnection and intercarrier compensation arrangements.

Minimizing transaction costs is another important goal for reform. When transaction costs are high, parties may be unable to achieve agreements that would otherwise be mutually beneficial. Transaction costs can be minimized in a manner that contributes to the development of competition. The Commission can do so by establishing clear, pro-competitive interconnection rules. The Commission's single-POI

[4] DeGraba Declaration at 11.

rule is an example of such a rule.’ By requiring competitors to interconnect at only a single point in each LATA, the Commission effectively avoided what would otherwise have been far more contentious and extended negotiations over this issue. Where multiple POIs have been more efficient, competitive LECs such as WorldCom have implemented them. The Commission’s approach implicitly recognized that new carriers entering a market would not have sufficient traffic volumes to justify multiple POIs. As traffic volumes in particular markets have increased, WorldCom has expanded the number of POIs in those markets in order to manage traffic exchanges with incumbent LECs efficiently.

In evaluating alternative proposals, the Commission must also be confident that the benefits of rearranging compensation and transport arrangements clearly outweigh their potentially significant costs. Existing interconnection arrangements were established only after lengthy periods of negotiation and litigation before scores of administrative and judicial tribunals. The cost of implementing substantial changes to these arrangements for WorldCom and other competitive LECs is potentially very significant. The Commission should not adopt changes that are likely to result in additional litigation and regulatory uncertainty. Such uncertainty will disproportionately harm competitive carriers, many of which may not have the resources for additional rounds before regulators and in the courts.

Moreover, the elimination of uneconomic disparities in rate structures and per-minute rate levels may provide far greater net benefits than would reform that might entail relocation of POIs and POPs, or significant network re-optimization. For example, the wide disparities between interstate and intrastate access charges and reciprocal

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[5] 47 C.F.R § 51.321.

compensation is likely to constitute a significant source of "regulatory arbitrage." By eliminating these disparities, the Commission would realize significant net benefits without causing costly network redesign.

The Commission should be careful not to implement reform that could result in substantial network redesign. This is particularly the case in light of the continued evolution from circuit- to packet-switched technology. Network engineers and capital investments should be allowed to focus on this evolution, and not on a short-term rearrangement of the circuit-switched network made necessary only by a change in regulation. The Commission must understand that network re-optimization caused by regulatory change can be a costly, time-consuming process for all carriers. Even a small rule change can result in the redirection of tens of millions of capital dollars and many thousands of engineering hours. Carriers must first assess the impact of a rule change on their optimal network design.[6] They must then determine the most cost-effective way to actually re-optimize their networks. Once a plan is in place, thousands of circuits may have to be ordered and/or disconnected to achieve the network changes required by a seemingly minor rule change.

III. Piece-Meal Implementation of Intercarrier Compensation Reform Is Likely to Produce Significant Anti-competitive Effects

An overriding objective of a unified scheme for intercarrier compensation is to ensure that the same rules apply to the termination of all traffic: local exchange, interstate and intrastate exchange access, as well as traffic destined for an ISP.[7] Establishing a

[6] A network is considered "optimal" when it provides the least-cost means of routing an anticipated traffic load.
[7] *See, e.g.,* Notice at ¶ 2.

uniform, "a minute is a minute" regime, such as an integrated bill and keep system for all traffic, would eliminate opportunities for uneconomic arbitrage and assign the costs of terminating traffic in a manner that will lead to efficient prices for all types services and traffic. As Dr. DeGraba explains in his Declaration, the COBAK approach to intercarrier compensation reform is intended to meet this key objective of a single unified pricing regime.[8] Dr. DeGraba further demonstrates the adverse economic and competitive effects of implementing COBAK on a piece-meal basis, specifically by imposing the COBAK scheme on compensation arrangements for local exchange and ISP-bound traffic, while delaying application of the plan to the treatment of interstate and intrastate toll traffic.' Moreover, piece-meal implementation would explicitly violate the Commission's goal of achieving reform that is competitively and technologically neutral.

The importance of uniform implementation of reform greatly complicates the Commission's task in this proceeding. As the Commission is aware, it does not have jurisdiction over intrastate access charges. Yet intrastate charges occupy a hugely disproportionate role in intercarrier compensation. For example, WorldCom's aggregate intrastate switched access expense is more than 30% larger than its corresponding interstate expense, even though WorldCom's interstate traffic is approximately triple its intrastate traffic.

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[8] DeGraba Declaration at 29.

[9] ***Id.*** at 30-32.

The Commission's recent reciprocal compensation order is a prime example of the dangers of piece-meal reform.” Under that decision, calls made to an ISP fall into a novel category of interstate access called “information access.”’[1] For some reason, this category of interstate access is billed at a different, lower rate than ordinary interstate access. In establishing this new category of access the Commission has undoubtedly enhanced existing arbitrage opportunities in a manner that will yield new disputes over whether or not particular services constitute “information access.”

When ISPs offer an Internet telephony long distance service, they may have a significant cost advantage over traditional providers of toll service because of the differences in the intercarrier compensation schemes that govern their traffic.[12] ISP-bound traffic is not subject to interstate or intrastate access charges pursuant to the FCC's long-established classification of ISPs as end users. In contrast, traditional long distance carriers must pay both originating as well as terminating access charges to local exchange carriers. Consequently, ISPs offering Internet telephony service incur only a fraction of the costs of their competitors to originate and terminate long distance traffic.

Implementing COBAK only for local exchange and ISP-bound traffic would not do anything to reduce substantially or eliminate this unfair regulatory advantage. Traditional long distance carriers would continue to pay per-minute interstate access charges while ISPs offering Internet telephony would pay, at most, a very small

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[10] *In the Matter of Intercarrier Compensation for* ***ISP-Bound*** *Traffic,* CC Docket No. 99-**68,** Order on Remand and Report and Order (rel. April 27,2001). WorldCom has filed an appeal of this order in the United States Court of Appeals for the District of Columbia Circuit.

[11] *Id.* at ¶ 44.

[12] **As** the quality of Internet telephony improves in the near future, this source of arbitrage will become increasingly significant.

termination charge to their carrier (which is currently recovered from the originating carrier under reciprocal compensation arrangements).[13]

Further, piece-meal implementation of a bill and keep regime would deprive WorldCom and other competitive LECs that offer both local exchange as well as long distance service of the opportunity to realize significant efficiency gains in operating their networks. As Dr. DeGraba explains, because local exchange and exchange access traffic today are regulated under separate regimes, the facilities used to carry the two different types of traffic are priced differently and, in the case of the transport segment, are provisioned over physically separate facilities.[14] Implementation of a unitary pricing scheme would eliminate the need for these uneconomic provisioning arrangements and allow competitive LECs to realize the scale and scope economies associated with being able to aggregate all of their traffic on common facilities and, in effect, to operate a single, integrated network, rather than two separate networks. It would also better comport with the Commission's goal of competitive neutrality. There is no reason why incumbent LECs should be allowed to aggregate local and access traffic while other carriers, including full-service providers such as WorldCom, are denied this fundamental efficiency. Staggered implementation of intercarrier compensation reform clearly would

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[13] Moreover, implementing COBAK or a similar bill and keep scheme for local exchange and ISP-bound traffic quickly while delaying more comprehensive reform would confer a substantial, unwarranted benefit on incumbent LECs while disadvantaging WorldCom and other long distance carriers. Under virtually all of its existing interconnection arrangements with incumbent LECs, WorldCom terminates more local traffic on its networks than it delivers to incumbent LECs for termination. As a result, WorldCom currently receives net monthly payments from incumbent LECs to cover those termination costs. If a bill and keep plan were implemented only for local exchange and ISP-bound traffic, the effect would be to relieve incumbent LECs of their obligation to pay for transport of that traffic while WorldCom and other IXCs would be required to continue to pay incumbent LECs to originate and terminate exchange access traffic.

[14] DeGraba Declaration at 31.

deprive competitive LECs of the opportunity to achieve these efficiency gains. Instead, they would be forced to continue to manage two different local networks.

IV. Regulatory Intervention on Pricing is Needed Only to Constrain the Exercise of Market Power

Under long-standing Commission precedent, price regulation is needed only where carriers possess market power. In proposing the adoption of mandatory bill-and-keep, the Commission has recognized that continued regulation of certain intercarrier interconnection and compensation regimes is needed. The Commission has also acknowledged that intervention is unnecessary with respect to Internet backbones and other interconnection arrangements where no provider is able to exercise market power. A review of Commission precedent on the circumstances in which price regulation is needed can shed light on the reasons why access and reciprocal compensation. arrangements continue to require regulatory oversight. Moreover, even if the Commission mandates an intercarrier compensation rate of zero, i.e., bill-and-keep, these arrangements will still be subject to the exercise of market power and will thus still require regulatory oversight.

The Commission has consistently relied on the presence of competition to eliminate unnecessary regulation. Between 1979 and 1985, the Commission conducted the Competitive Carrier proceeding, in which it examined how the application of its regulations to new, competitive entrants should be reduced or eliminated.[15] In this proceeding, the Commission concluded that the Communications Act of 1934 provided it

[15] *Policy and Rules Concerning Rates for Competitive Common Currier Services and Facilities Authorizations Therefor,* CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 F.C.C. 2d 308 (1979) *(Competitive Carrier).*

with substantial discretion with respect to Title II of the Act, including the discretion to refrain from applying the full panoply of Title II regulation, so long as that discretion was exercised in a manner that effectuated the Act's overarching goals.[16] In 1980, in its First Report & Order in this proceeding, the Commission decided that it was unnecessary to apply its Title II rate and entry regulations to carriers that lacked sufficient market power to engage in anti-competitive activity.[17] Accordingly, the Commission established a regulatory framework to distinguish between those carriers with market power,[18] which are classified as dominant, and those that lack market power, which are classified as non-dominant.[19] The Commission found that tariff filing requirements were unnecessary for these non-dominant carriers because they had neither the ability nor the incentive to engage in the anti-competitive practices prohibited under the Act.[20]

In 1995, the Commission found it unnecessary to regulate AT&T in the interstate, domestic, interexchange market. The Commission reclassified AT&T as a non-dominant carrier, based on the Commission's finding that AT&T no longer possessed market power taken as a whole. In making this determination, the Commission considered four factors: 1) AT&T's market share; 2) the supply elasticity of the market; **3)** the demand elasticity of AT&T's customers; and 4) AT&T's costs structure, size and resources to

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[16] *Competitive **Carrier,*** First Report and Order, 85 F.C.C. 2d 1, 20-24 (1980).
[17] ***Id.** at* ¶¶ 25-27.
[18] *Id.* The Commission defined a dominant carrier as one that "possesses market power" and noted that control of bottleneck facilities was "prima facie evidence of market power requiring detailed regulatory scrutiny." ***Id.*** at ¶¶ 55-59.
[19] *Id.* Under this framework, if a common carrier was determined to be "non-dominant," Title II regulatory requirements would be "streamlined." ***Id.*** at ¶ 27.
[20] ***Id.*** at ¶¶ 30-49. Specifically, tariffs filed by non-dominant carriers would be presumed lawful and would be subject to reduced notice periods. ***Id.*** at ¶ 96.

conclude that AT&T lacked sufficient market power dominate the long distance market.[21] As a non-dominant carrier, AT&T was no longer subject to price cap regulation for its residential, operator, 800 directory assistance, and analog private-line services.[22] Since this decision, the Commission has declined to regulate the long-distance prices charged by any interexchange carrier for any service.[23]

In at least one instance, the Commission has unwisely reduced or eliminated price regulation without finding that the regulated carriers no longer possess market power. In 1999, in its Access Charge Reform, Pricing Flexibility Order,[24] the Commission gave price cap LECs immediate pricing flexibility for some interstate access services[25] and established procedures through which LECs could seek substantial additional relief from existing price cap regulation merely upon showing that certain proxies for competition had been achieved.[26] The risk of this approach is that it exposes competitors and customers to the exercise of market power if the Commission's proxies do not adequately represent actual competition. While price cap LECs have subsequently obtained

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[21] *Motion of AT&T to be Reclassified as a Non-Dominant Carrier,* 11 F.C.C.R. 3271 (1995).

[22] *Id.*

[23] The reason for this is simple. In the absence of a carrier's ability unilaterally to raise prices or restrict output profitably, there is no need for rate regulation. The marketplace determines long-distance prices.

[24] *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA,* Fifth Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, CC Docket No. 94-1, CCB/CPD File No. 98-63, CC Docket No. 98-157 14 F.C.C.R. 14,221 (1999).

[25] *Id.* Price cap LECS could immediately deaverage services in the trunking basket. Certain interstate interexchange services would be removed from price cap regulation upon implementation of intra- and interLATA toll dialing parity. *Id.*

[26] *Id.* The Commission granted additional pricing flexibility to incumbent LECs through a series of collocation-based triggers, deregulation of new services, and deaveraging of rates.

significant pricing flexibility in a number of markets, their customers have so far enjoyed no benefit, in the form of reduced prices or improved services, from this departure from the Commission's normal approach to removing price regulation.

As these examples demonstrate, the Commission has long recognized that intervention in pricing matters is needed only where one or more carriers can exercise market power. In the case of interconnection arrangements, incumbent LECs possess market power now and would continue to possess it even if the Commission adopted a system of mandatory bill-and-keep. In those circumstances, the Commission would still have to enforce safeguards against the exercise of market power by incumbent LECs to harm competition.

V. Limitations on its Authority May Prevent the Commission from Implementing a Regime of Mandatory Bill-and-Keep

As this review shows, the Commission has a long history of reforming pricing rules where doing so better promotes or reflects competitive conditions. In this case, WorldCom strongly supports the implementation of reform that would produce a unified interconnection regime in which "a minute is a minute," without regard to the jurisdictional nature of the traffic. As described in the DeGraba Declaration, such a regime would allow competitive carriers to achieve substantial efficiencies in the operation of their networks. However, the Commission's ability to achieve such unified reform is, to some extent, limited by its statutory and jurisdictional authority. For the reasons outlined above, the Commission should not pursue piece-meal reform, which may only exacerbate existing inefficiencies and incentives for arbitrage. The Commission should instead pursue reform that reduces or eliminates rate level disparities.

An important limitation on the Commission's authority is its lack of jurisdiction over intrastate access charges. **As** shown above, the disparity between intrastate access and other forms of regulated intercarrier compensation dwarfs other disparities that may exist.[27] Indeed, it is likely that this disparity, if allowed to continue, will result in far more "regulatory arbitrage" than any other interconnection pricing anomaly. Unless the Commission finds a way to bring intrastate access charges into line with interstate access and reciprocal compensation, other reform may prove unavailing and may even be harmful insofar as it exacerbates the arbitrage opportunity presented by intrastate access.

Since the Commission cannot itself order reductions in intrastate access charges, it will have to work with the state commissions to reduce these charges. The Commission could pursue a cooperative process with the states to assess how to bring about significant reform of intrastate access charges.[28] In any case, until progress can be made on intrastate access charges, the Commission should not delude itself into thinking that piece-meal reform of reciprocal compensation or interstate access can succeed in reducing or eliminating "regulatory arbitrage."

Indeed the failure to address intrastate access charges will guarantee continuing arbitrage. **As** the Commission has pointed out, "any discrepancy in regulatory treatment between similar types of traffic or similar categories of parties is likely to create opportunities for regulatory arbitrage."[29] Such opportunities will undoubtedly be greatest where the discrepancy is widest and traffic is most similar, In this case, the discrepancies

[27] *Supra. at* 10.
[28] The states may be hesitant to adopt new or increased end user charges as the Commission did in the ***CALLS*** proceeding. But, at the same time, they may also be concerned that the Commission's reciprocal compensation order will yield new arbitrage resulting in significant reductions in incumbent LEC intrastate access revenues.
[29] Notice at par. 12.

are widest with respect to intrastate access. The traffic is identical. From the network's perspective, a minute is a minute. Arbitrage is inevitable.

As the Commission has previously recognized, there are circumstances in which arbitrage is a useful means of exposing and eliminating uneconomic charges. Here, insofar as interstate access and reciprocal compensation are priced at more economic levels than intrastate access, the Commission could hail its policies as pro-competitive measures intended to promote beneficial regulatory arbitrage and thereby expose over-priced intrastate access charges to the light of competition. However, some parties may claim that the current level of intrastate access charges is needed to subsidize affordable local rates. If the Commission accepts this, then the best alternative is to pursue cooperative reform of intrastate access charges to end the regulatory arbitrage that the Commission's own policies will otherwise create.[30]

Thus, the first logical step in reforming interconnection and intercarrier compensation is to reduce the disparity between intrastate access charges and other charges for the identical network functionality. Once accomplished, the Commission can turn its attention to establishing a unified Compensation regime. Here, the Commission's authority is also limited. While WorldCom recognizes that some form of bill-and-keep may be an efficient regime for interconnection and compensation in certain circumstances, the Commission may not have statutory authority to adopt bill-and-keep

[30] It bears repeating that the Commission may already have opened the door to widespread arbitrage that will spell the end of intrastate access as a subsidy source. In its reciprocal compensation order, the Commission found that ISPs depend upon "information access." The Commission established rate levels for "information access" that are many magnitudes lower than intrastate access charges. Since the Commission has also found that ISP-bound traffic is "interstate," it is quite possible that ISP connections will replace FGD as the primary means of providing competitive intrastate toll services,

in all circumstances. 47 U.S.C. § 252(d)(2) establishes pricing standards for the appropriate charges for reciprocal compensation for traffic exchanged with incumbent LECs.[31] Section 251(c)(2) plainly requires the establishment of a reciprocal compensation rate that complies with the "additional cost" requirement of section 252(d)(2). With respect to reciprocal compensation for traffic exchanged with incumbent LECs, the originating carrier must compensate the terminating carrier based on a reasonable approximation of the additional costs of termination.

The Commission has previously found that this language permits the imposition of bill-and-keep only where the traffic exchanged is relatively in-balance.[32] For out-of-balance traffic, the Commission has determined that cost-based reciprocal Compensation must be paid. Clearly, there is one circumstance in which the Commission could mandate bill-and-keep for out-of-balance traffic governed by this section of the Act. The Commission could find that there are no additional costs of terminating these calls, leaving aside transport costs. In other words, the Commission could find that the costs of termination, primarily switching costs, are completely usage insensitive. Such a finding would also have significant repercussions for the pricing of switching as an unbundled network element. If switching costs are usage insensitive, then unbundled switching must be priced on a flat-rated basis to meet the statutory requirement of cost-based pricing for unbundled network elements.

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[31] According to that section: "For the purposes of compliance by an incumbent [LEC] with section 251(b)(5), a State Commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) such terms and conditions determine such costs on a reasonable approximation of the additional costs of terminating such calls."

It is clear that the Commission should act to eliminate the disparate regulatory treatment of traffic that is otherwise indistinguishable. This requires that the Commission first address the huge disparity between intrastate access charges and other compensation mechanisms. The Commission could then pursue additional reform, limited by the statutory requirements governing reciprocal compensation for traffic exchanged with incumbent LECs. However, the Commission cannot mandate the adoption **of** any bill-and-keep mechanism for significantly out-of-balance traffic unless it finds that the cost of switching is usage insensitive.

VI. Implementation of any Bill-and-Keep Proposal Must be Grounded in the Commission's Authority and Should be Implemented in a Pro-competitive Manner.

As noted above, the Commission cannot mandate any bill-and-keep regime unless it first finds that switching costs are usage insensitive. If the Commission makes this finding, it must also mandate that unbundled switching be priced on a flat-rated basis.

The Commission has sought comment on two slightly different versions of bill-and-keep. Both COBAK and BASICS have certain strengths and weaknesses. **As** a practical matter, COBAK appears to be a better-developed, more easily implemented proposal. However, as the DeGraba Declaration makes clear, the OPP white paper on COBAK does not address all issues associated with its implementation. In particular, the paper does not explicitly address how implementation of COBAK changes the opportunities for a carrier with market power to harm its rivals. Dr. DeGraba addresses this issue in his declaration. WorldCom views COBAK, with the additional analysis presented in Dr. DeGraba's declaration, as a reasonable, pro-competitive approach to

[32] *See, e.g.,* **47** C.F.R. § 51.713(b).

intercarrier compensation reform. This assumes that COBAK could be implemented on a unified basis, and that the Commission could find that carriers incur no "additional costs'' to terminate calls that originate on the networks of other carriers.

At its core, COBAK comprises two straightforward rules: (1) carriers may not recover the costs of local access facilities from interconnecting carriers; (2) the calling party's network is responsible for the cost of transporting a call to the called party's central office. **As** is discussed above, there are significant potential efficiencies available from implementation of COBAK as a uniform interconnection regime. However, many of the benefits of COBAK would be lost if it could not be implemented as a uniform regime.

Given the limitations on the Commission's authority to mandate any system of bill-and-keep for local traffic exchanged with incumbent LECs, the Commission may find itself unable to adopt COBAK as a uniform interconnection regime. If, however, the Commission finds that there are no "additional costs" of terminating traffic, and that accordingly it has authority to mandate bill-and-keep, the Commission should only consider adopting COBAK, or any other system of bill-and-keep, in a manner that addresses the issues raised in Dr. DeGraba's declaration.

First, since COBAK does not change the cost responsibilities of interconnecting carriers for the exchange of local traffic, adoption of COBAK would not require any changes to existing rules that were adopted to constrain the incumbent LECs' exercise of market power. According to Dr. DeGraba, "[a] general reconsideration of these rules and obligations . . . could hinder the development of competition and harm consumers."[33]

[33] DeGraba Declaration at 27.

Thus, if implemented, COBAK should entail no changes to any of the Commission's interconnection rules except for the rule governing the payment of termination charges. For example, the Commission should retain the single-POI per-LATA rule. This rule allows requesting carriers to interconnect with incumbent LECs at a single point in each LATA. Competitive LECs have found that this rule prevents incumbent LECs from demanding needlessly duplicative interconnection points. Where traffic is sufficient to justify additional POIs, competitive LECs have agreed to their establishment. For example, WorldCom interconnects at multiple POIs in the large majority of its MSAs.[34] In many cases, dedicated connections to individual incumbent LEC central offices have been established.

Any change in the Commission's rules that would enable incumbent LECs to demand, for example, that requesting carriers interconnect at every central office would constitute a severe blow to competition. It would be relatively easy for the incumbent LECs, with their vast networks, to establish dedicated facilities to every competitive LEC central office, particularly since competitive LECs tend to operate no more than one or two switches in any **MSA.** However, competitive LECs would incur substantially greater costs to provision dedicated interconnection facilities to the large number of central offices that incumbent LECs operate in each MSA.[35]

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[34] It is WorldCom's understanding that other competitive LECs have also agreed to establish additional POIs where needed.

[35] WorldCom estimates that it costs, on average, more than $1 million to extend its network *to* any individual incumbent LEC central office. The per-minute cost of leasing highly underutilized dedicated facilities would be also be prohibitively high. In the *UNE Remand Order,* the Commission found that total number of competitive LEC switches represents only a small fraction of the corresponding number of incumbent LEC switches. *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, Third Report and Order (rel. November 5, 1999), ¶ 254.

The Commission must also continue to require incumbent LECs to provide transport between the interconnection point and the called party's end office at TELRIC-based rates.[36] The Commission has found that, under the Act, incumbent LECs must provide transport based on the forward-looking costs of providing it. This rule allows competitive LECs to benefit from some of the economies of scale and scope that the incumbent enjoys as a result of its legacy status as the monopoly provider of local exchange service. Without this rule, competitive LECs would be at a substantial cost disadvantage compared to incumbent LECs, thus violating the goal of competitive neutrality.

The Commission should also retain the rule requiring incumbent LECs to provide transport over two-way trunks. Two-way trunks allow traffic to flow in either direction at any given point in time. As Dr. DeGraba's declaration describes, such trunks are far more efficient than one-way trunks.[37] Two-way trunks allow the aggregation of a greater volume of traffic on a single facility. This aggregation allows carriers to enjoy higher average utilization of transport facilities, thus minimizing the average cost of transport.[38]

As Dr. DeGraba's declaration makes clear, any general reconsideration of these rules could hinder the development of competition and harm consumers. Not only would such reconsideration impose higher costs on competitive LECs, it could also produce additional regulatory uncertainty and litigation. The Commission's has already found that, under the Act, incumbent LECs must provide any technically feasible means of interconnection, including interconnection at a single point in each LATA and the use of two-way trunks. Any change to these decisions would likely result in additional litigation

[36] 47 C.F.R. § 51.705(a)(1).
[37] DeGraba Declaration at 13-14.

and uncertainty pending resolution of the litigation. This uncertainty would result in a higher cost of capital for the competitive LEC industry, which already faces severe capital constraints. It would also delay the roll out or expansion of competitive services, and divert competitive LEC resources from market entry to participation in regulatory proceedings and litigation. It would also create new opportunities for non-cooperative behavior by incumbent LECs.

Second, COBAK would change the cost responsibility for originating interexchange traffic. **Up** until now, IXCs have been responsible for the cost of transporting originating interexchange traffic from the calling party's central office to the IXC's POP. Under COBAK, the originating LEC would bear the cost responsibility for this transport. **As** Dr. DeGraba demonstrates, an incumbent LEC could use its control over the routing of originating interexchange traffic to disadvantage IXCs and harm customers.[39]

By routing originating traffic over facilities different from those previously established by the IXC, the incumbent LEC could leave the IXC with stranded facilities wherever the IXC has either self-provisioned or entered a long-term lease arrangement.[40] At the same time, the IXC would likely see a reduction in the revenue available to support these now-stranded facilities, assuming that prices in the interexchange market fall to reflect the change in transport responsibilities. Stranded costs combined with

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[38] *Id.*
[39] ***Id.*** at 12.
[40] The vast majority of WorldCom's dedicated end office trunks are either purchased from incumbent LECs pursuant to long-term commitments or self-provisioned. Moreover, originating traffic exceeds terminating traffic for several reasons. Accordingly, the removal of originating traffic from these trunks would greatly reduce their utilization.

reduced revenues will inevitably depress IXC profits, and increase the IXC's cost of

By routing traffic over different facilities than those established by the IXC, the incumbent LEC would effectively convert the IXC's remaining facilities to one-way trunks used exclusively for terminations. Since one-way trunks are less efficient than two-way trunks, this would raise the IXC's cost for terminations, thus making the IXC less competitive.[42]

Finally, and most troubling, by controlling the transport facilities for interexchange originations, the incumbent LEC could strategically diminish the quality of interconnection received by an IXC. Today IXCs closely monitor usage and blocking rates on dedicated trunks. When blocking reaches a certain threshold, trunk groups are augmented. If the incumbent re-routed originating traffic over its own network, the IXC would have no way to monitor the level of call-blocking for calls that originate in any particular central office. For an incumbent LEC that also provides interexchange service, the ability to degrade the quality of interconnection to its rivals will provide a new opportunity to exploit its market power to the detriment of competition and consumers.

As Dr. DeGraba shows, it is unlikely that there would be an efficiency justification for this behavior.[43] Any efficiency justification for re-routing originating traffic would, in all probability, apply equally to terminating traffic. There is no legitimate public policy reason for incumbent LECs to make different routing choices than IXCs for this traffic. Accordingly, **if** the Commission adopts COBAK or a similar bill-and-keep regime, it should also adopt rules to prevent incumbent LECs from routing

[41] DeGraba Declaration at 15-15

[42] *Id.*

originating traffic over facilities other than those used by the IXC to route its terminating traffic. One such rule, as an example, could require that while IXCs determine how traffic will be routed, incumbent LECs are responsible for a pro-rata share of the costs of the facilities selected by the IXC based on the proportion of originating minutes to terminating minutes.

Dr. DeGraba also describes how incumbent LECs could manipulate rate structures to disadvantage IXCs.[44] For example, incumbent LECs might impose per-minute charges on end users that select rival IXCs, but offer a flat-rated product to end users that purchase interexchange services from the incumbent LEC or an affiliate. This strategy would harm competitors as well as customers. Competitors would be harmed because their services would be made less attractive, particularly to high usage customers. Customers would be harmed because, by insulating the incumbent LEC from competition, this strategy would produce higher prices for interexchange service than would otherwise exist.

The BASICS proposal, like COBAK, also would replace existing compensation mechanisms with a form of bill-and-keep. BASICS also comprises two rules: (1) networks should recover all intra-network costs from their subscribers; and (2) networks should divide equally the costs that result purely from interconnection. The first rule does not appear to differ in any significant way from COBAK. However, the rule governing the division of transport costs is quite different from COBAK.

On its face, a requirement that carriers equally divide the costs of interconnection appears eminently fair and reasonable. But the implementation of such a rule appears

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[43] *Id.* at 18-19.
[44] ***Id.*** at 19-24.

quite daunting. How would carriers identify the costs of interconnection, particularly when one carrier is the provider of the interconnection facilities? How would disputes be adjudicated over the appropriate costs to be divided?

As with COBAK, BASICS would do nothing to eliminate the market power possessed by the incumbent LECs. It would simply change the circumstances under which their market power might be exercised. Since BASICS does not appear to have any advantages over COBAK, but raises some significant unresolved issues related to its implementation, WorldCom does not view BASICS as a sound basis for intercarrier compensation reform.

VII. Conclusion and recommendation.

WorldCom strongly supports the implementation of a uniform regime for interconnection and intercarrier compensation. There are significant, potential efficiencies available from eliminating the irrational segregation of traffic that plagues existing interconnection arrangements. The maintenance of separate facilities for local and access traffic is nonsensical from an engineering perspective. The widely divergent rates for intrastate access, interstate access, "information access," and ISP connections create incentives for substantial "regulatory arbitrage."

WorldCom believes that COBAK, with the additional analysis presented in Dr. DeGraba's declaration, would, if implemented on a uniform basis, constitute a significant improvement over the existing irrational, patchwork of regulation. However, as described above, the Commission's authority to mandate bill-and-keep for the exchange of traffic subject to section 251(c)(2) of the Act is limited. Unless the Commission finds that the cost of termination, i.e., switching, is usage insensitive it simply cannot mandate bill-and-keep for the exchange of local traffic where it is out-of-balance.

Since the Commission cannot mandate bill-and-keep for reciprocal compensation, absent a finding that the "additional" costs of termination amount to zero, WorldCom recommends the adoption of a unified mechanism for intercarrier compensation under the standards established by section 251 of the Act. The Commission should seek to establish a uniform rate for call termination based on forward-looking cost. That rate should apply to all terminations, irrespective of whether the call is "local," "interstate access," or "intrastate access." To accomplish this, the Commission should initiate a cooperative approach to intrastate access reform with the states. Unless intrastate access charges are included, any reform may exacerbate, not eliminate incentives for "regulatory arbitrage."

For the reasons set out above and in Dr. DeGraba's declaration, the Commission should maintain existing local interconnection rules, including the single-POI rule and the requirement that incumbent LECs provide transport at a TELRIC-based rate from the POI to the called party's central office. Without these rules, competitive LECs would incur substantially greater interconnection costs than incumbent LECs, and would thus be at a significant competitive disadvantage.

The Commission should eliminate traffic sensitive charges paid by IXCs to LECs for originating access. These charges distort interexchange competition and place IXCs at a competitive disadvantage whenever the LEC also competes in the interexchange market. LECs should be allowed to recover these sums only from end users directly, and should be prohibited from bundling interexchange service with local service in a manner that would discriminate against customers that select an alternative interexchange provider.

Finally, the Commission should allow IXCs to continue to control all routing decisions with respect to originating and terminating interexchange traffic. **As** Dr. DeGraba's declaration makes clear, incumbent LEC control over these routing decisions would carry with it unacceptable risks of anti-competitive behavior.

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August 21,2001

ATTACHMENT

DECLARATION OF PATRICK DEGRABA

IMPLEMENTING BILL AND KEEP INTERCARRIER COMPENSATION

WHEN INCUMBENT LECS HAVE MARKET POWER

DECLARATION OF PATRICK DeGRABA

Charles River Associates

August 20,2001

EXECUTIVE SUMMARY

The Notice of Proposed Rulemaking released by the Federal Communications Commission (FCC or Commission) in this proceeding seeks comment on the adoption of a "bill and keep" system, such as Central Office Bill and Keep (COBAK), for all intercarrier compensation arrangements. Implementation of a COBAK or other bill and keep regime, should take into account that incumbent local exchange carriers (LECs) possess market power, both where they control facilities essential for the provision of many telecommunications services that currently cannot be duplicated in a cost-effective manner, and where they enjoy economies of scale competitors cannot duplicate. Incumbent LECs also enjoy advantages because they serve the vast majority of customers. They would retain market power and advantages under a COBAK regime and, absent constraints, could use them to disadvantage rivals, which ultimately would harm competition and consumers. Implementing COBAK, therefore, must account for the following:

1. Incumbent LECs could raise competing interexchange carriers' (IXCs') cost of providing service, relative to the cost of the competing incumbent LEC interexchange service, by routing originating toll traffic in ways that would limit the IXCs' ability to monitor blocking rates and would deny IXCs scale economies they now enjoy because they transport both originating and terminating access traffic.

2. Incumbent LECs could disadvantage rival IXCs by manipulating the structure of rates that recover the costs of originating access directly from end users under COBAK. Recovering these costs from customers of competing IXCs with a less efficient rate structure, such as a simple per-minute charge, and from customers of their own interexchange service with more efficient rate structures that included flat charges would make the services offered by IXCs relatively less attractive to customers. [1]

3. Many existing interconnection rules designed to constrain the ways in which incumbent LECs could exercise market power need not be altered as a result of COBAK. **A** general

[1] Usage charges will often be less efficient than flat-rated charges. See note 22 *infra* and accompanying text.